South Carolina Board of Economic Advisors
Statement of Estimated State Revenue Impact

Date: June 6, 2007 (As amended May 31, 2007 by the Senate)

Bill Number: S.B. 91

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Committee Requesting Impact: House of Representatives

Bill Summary
A bill to enact the Research and Development Tax Credit Reform Act by amending Section 12-6-3415, as amended, Code of Laws of South Carolina, 1976, relating to the corporate income tax and corporate license tax credit allowed taxpayers claiming a federal income tax credit for research activity, so as to allow the credit against any income tax imposed pursuant to the South Carolina Income Tax Act.

REVENUE IMPACT [1/]
This bill, as amended, is expected to reduce General Fund corporate and individual income tax revenue by an estimated $5,250,000 in FY2007-08. Sales tax revenue would be decreased by $3,900,000 in FY2007-08. Of that total, $2,600,000 would be a decrease in General Fund sales tax revenue, $650,000 would be a decrease in EIA Funds, and 650,000 would be a decrease in Homestead Exemption Funds. In total, this bill, as amended, is expected to reduce General Fund revenue by an estimated $7,850,000 in FY2007-08.

Explanation of Amendment (May 31, 2007) – By the Senate
This amendment would add the language from H.B.3372, as amended, to the bill. The following sections of the amendment are expected to have an impact on General Fund revenue in FY2007-08.

Section 2. This section amends Section 12-14-80 to amend the criteria to allow a manufacturer to claim an economic impact zone credit pursuant to Section 12-14-60 for capital investments placed in service outside of an economic impact zone after June 30, 2007. The manufacturer must meet the following criteria to qualify - have a facility in at least one economic impact zone; be established in an activity listed under the NAICS code 326; employ at least 5,000 full-time workers in this State and have capital investment of not less than $2,000,000,000; and has invested $500,000,000 in this State between January 1, 2006 and July 1, 2011. Multiplying a capital investment of $500,000,000 by 20 percent and applying an economic impact zone credit of five percent yields a reduction in General Fund corporate and individual income tax revenue of an estimated $5,000,000 in FY2007-08.

Section 10. Currently, small taxpayers with less than $1,000,000 in gross income and taxable incomes less than $100,000 may elect to treat 50% of income as not related to personal services. This bill proposes to modify this safe harbor provision to delete the less than $1,000,000 in gross income limitation. This deletion along with the exclusion of capital gains and losses may allow more taxpayers to become eligible for the election. However, due to the anticipated complexity of the determination of personal service income, which these small taxpayers will have to determine only for state tax purposes, we expect that this election by taxpayers will increase some taxpayers' income tax liability and decrease others. We expect that the net result will be revenue neutral.

Section 32. This section was amended to remove language that would have made property tax disputes with the Department of Revenue retroactive for property tax years beginning after 2000.

The following sections of H.B.3372, as amended April 18, 2007 by the House Ways & Means Committee, were removed from H.B.3372 as S.B.91 was amended.

Section 16 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Allow taxpayers that do not withhold more than $1,000 in a calendar year to file its withholding taxes annually before the last day in February in the following calendar year instead of the current monthly or quarterly schedules.)

Section 23 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Would make it a felony for a person who submits a false or fraudulent W-2 form in the filing of his income tax return to be fined not more than $5,000 or imprisoned not more than five years, or both, together with the cost of prosecution.)

Section 40 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Sales tax exemption for electricity used by greenhouses to irrigate plants.)

Section 42 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Sales tax exemption on certain pharmaceutical agents and medical supplies purchased and stockpiled by the state for exclusive use in declared emergencies, major disasters, or influenza pandemics.)

Section 50 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Allow the Department of Revenue to amend the 2007 Index of Taxpaying Ability.)

Section 57 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Allow Subchapter S shareholders of a bank a tax credit that effectively excludes the shareholders' prorata share of the net items of income and expense from the bank.)

Section 61 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Allow real property of manufacturers used primarily for warehousing and wholesale distribution to become subject to a 6.0% assessment ratio instead of a 10.5% assessment ratio.)

Section 63 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Would exempt counties that collect more than $900 in accommodations tax revenue in one fiscal year from the Sunday Blue Law provisions contained in Chapter 1 of Title 53.)

Section 64 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Would allow the Department of Revenue to compensate motion picture production companies up to 20% of the total payroll for persons employed in connection with a film production.)

Section 66 from H.B.3372. This section was deleted when the language from H.B.3372 was amended to S.B.91. (Would reduce the top marginal individual income tax rate from 7.0% to 6.83% for taxable years beginning after 2006.)

Explanation of Amendment (May 23, 2007) – By the Senate

Section 2. This section amends the criteria to allow a manufacturer to claim an economic impact zone credit pursuant to Section 12-14-60 for capital investments placed in service outside of an economic impact zone. The manufacturer must meet the following criteria to qualify - have a facility in at least one economic impact zone; be established in an activity listed under the NAICS code 326; employ at least 5,000 full-time workers in this State and have capital investment of not less than $2,000,000,000; and has invested $850,000,000 in this State between January 1, 2006 and July 1, 2011.

The section is also amended to require the taxpayer to elect to take the tax credit either as an income tax credit or a withholding tax credit but not both. The taxpayer must first apply the tax credits against any corporate tax liability in a year the taxpayer has corporate tax liability. Only then may the withholding tax credit be taken when the maximum investment tax credit applied against corporate income tax liability has been exhausted. The withholding tax credit may only be taken for qualifying investments made or placed in service after July 1, 2007.

This section takes effect July 1, 2007, and applies for capital investments placed in service outside of an economic impact zone after June 30, 2007, and for quarterly state withholding returns due on and after that date. In addition, for the period July 1, 2007 to June 30, 2008 (FY2007-08), a taxpayer may not reduce its state withholding tax to less than the withholding tax remitted for the period June 30, 2006 to July 1, 2007. Multiplying a capital investment of $850,000,000 by 20 percent and applying an economic impact zone credit of five percent yields a reduction in General Fund corporate and individual income tax revenue of an estimated $8,500,000 in FY2007-08.

Explanation of Amendment (May 16, 2007) – By the House of Representatives
Section 1. This section is the original bill as filed January 9, 2007. This section is expected to reduce General Fund individual income tax revenue by $250,000 in FY2007-08.

Section 2. This section would add Section 12-14-80 to allow a manufacturer an economic impact zone credit pursuant to Section 12-14-60 for capital investments placed in service outside of an economic impact zone after June 30, 2007. The manufacturer must meet the following criteria to qualify - have a facility in at least one economic impact zone; be established in an activity listed under the NAICS code 326; employ at least 5,000 full-time workers in this State and have capital investment of not less than $850,000,000; and will invest an additional $350,000,000 in this State before July 1, 2011.

An economic impact zone is a county or municipality that is located within 50 miles of the boundaries of a federal military installation or applicable federal facility that has been adversely impacted by the closing, realignment, or downsizing of the installation or facility. Currently, 27 counties qualify as economic impact zone counties. According to the Department of Revenue, the amount of the tax credit may be applied as an economic impact zone credit pursuant to Section 12-14-60, or against job tax credits earned pursuant to Section 12-6-3360, or up to fifty percent of the employee's withholding against the employer's quarterly estimated state income tax payments. The employer may select either of the three tax credit options not to exceed the amount of the economic impact zone tax credit.

The economic impact zone credit is five percent of qualified manufacturing and productive equipment property. The property must be tangible personal property under Sections 168 and 1245 of the IRS Code and used as an integral part of the manufacturing process. Manufacturing equipment amounts to 20 percent of the total cost of a typical capital investment project. Multiplying a capital investment of $350,000,000 by 20 percent and applying an economic impact zone credit of five percent yields a reduction in General Fund corporate and individual income tax revenue of an estimated $3,500,000 in FY2007-08. Any unused credits may be carried forward for ten years.

This section takes effect July 1, 2007, and applies for capital investments placed in service outside of an economic impact zone after June 30, 2007, and for quarterly state withholding returns due on and after that date. This section would result in a reduction of General Fund corporate and individual income tax revenue of an estimated $3,500,000 in FY2007-08.

Section 3. This section would add an appropriately numbered item to Section 12-36-2120 that creates a sales and use tax exemption for a taxpayer that constructs and operates a qualifying amusement park or theme park. The taxpayer is required to make a capital investment of a least $250,000,000 at a single site and create 250 full-time jobs and 500 part-time or seasonal jobs. The eligible taxpayer must meet the required investment and job creation requirements over a five-year period. According to information provided by the developer of an amusement park in Horry County, an estimated $65,000,000 of capital investment in amusement rides and park venues, net of land acquisition costs, is expected to be under development in FY2007-08. A sales and use tax exemption on the amusement rides and venues would reduce sales and use tax revenue by an estimated $3,900,000 in FY2007-08. Of this amount, General Fund sales and use tax revenue would be reduced by an estimated $2,600,000, Education Improvement Act (EIA) funds would be reduced by an estimated $650,000, and the Homestead Exemption Trust Fund would be reduced by an estimated $650,000 in FY2007-08.

Section 4. This section would amend the South Carolina Venture Capital Act of 2005 removing the term “regulations” from the statute, providing a definition for “interest”, and clarifies that out-of-state financial institutions that can prove prior experience in state-based venture capital programs and prior investments in South Carolina or South Carolina based companies may be considered “lenders” under this provision. This amendment provides technical changes to current law. This section, therefore, is not expected to have an impact on General Fund revenue in FY2007-08.

Explanation of Bill filed January 9, 2007
This bill provides an individual income tax credit equal to 5% of the taxpayer’s qualified research expenditures made in South Carolina. Corporate income taxpayers already may claim this credit against their corporate income tax liability or their license fee liability. This bill would expand the use of the credit to individual income taxpayers. This proposed South Carolina tax credit is based on the federal income tax credit contained in Section 41 of the Internal Revenue Code and is equal to 20% of a taxpayer’s increased qualified research expenditures over their average base research expenditures during the past four years. Qualified research expenses are limited to research undertaken to discover information that is technological in nature, and its application must be intended for use in developing a new or improved business component of the taxpayer. The research must relate to new or improved function, performance, reliability, or quality. Market research and normal product testing costs are not research expenditures. This federal credit is available for amounts expended through December 31, 2007 and sunsets after that date unless extended by Congress. Since the proposed state credit and the federal credit are identical except for the tax credit percentage, federal tax credit estimates can be used to calculate the impact on South Carolina income tax revenue from the proposed tax credit. The Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2005-2009* estimates that the qualified research expenditures tax credit will reduce federal individual income tax revenue by an average of $100 million. Applying South Carolina’s 1% ratio of total population and personal income to these U.S. totals suggests that $1 million of the federal tax credit is from South Carolina taxpayers. Since the proposed South Carolina tax credit is 5% of qualified research expenses, rather than the 20% federal tax credit, we expect that this bill would reduce General Fund individual income tax revenue by $250,000 in FY 2007-08.

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[1/] This statement meets the requirement of Section 2-7-71 for a state revenue impact by the BEA, or Section 2-7-76 for a local revenue impact, or Section 6-1-85(B) for an estimate of the shift in local property tax incidence by the Office of Economic Research.